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House And Senate Approve Trade Bill; Veto Likely

The House of Representatives approved the conference committee's compromise trade bill April 21 by an overwhelming 312-107 majority, more than enough to override the expected presidential veto. The debate centered largely around a provision requiring employers to give advance notification of plant closings or mass layoffs. It was the inclusion of this item in the bill that shifted the White House message from "willing to negotiate" to "ready to veto."

Third, the visibility of Japanese products encourages attention. The success that Japanese industry has had in penetrating the U.S. market is obvious from the number of Japanese cars and other consumer items that Americans see every day. Far less conspicuous are Dutch and British products. The recent rapid expansion of Japanese investment here -- whether in production facilities, real estate or financial terms -- has served to sharpen the debate.

Then, too, some observers argue that Americans perceive Japan's direct investments as more exclusionary than those of other countries. Because top management positions are often held by Japanese, these observers argue, American workers believe they have fewer opportunities for advancement. And finally, charges of racism abound. Critics on both sides of the Pacific argue that the emphasis on Japan's economic activities has overtones from which this country's Anglo-Saxon trading partners do not suffer.

The extent to which each of these factors influences the foreign investment debate is open to question. Still, they all play at least some role in what many analysts fear is an increasingly xenophobic environment. But even this label shifts the debate into dangerous waters. Some congressional staff members have begun to lament the fact that the debate has thus far been limited to simplistic and emotional terms. What would be more useful, they say, is a rational discussion of the effects of foreign investment on this country's economy, national security and growing feelings of economic nationalism.

Eileen M. Doherty

Japan's International Financial Power

Japanese investors triggered last year's stock market crash, the most calamitous financial event in recent memory, according to the head of the White House task force that studied the October event. Nicholas Brady, who may be in line for a high position if the Republicans retain the presidency, says Japanese firms dumped enormous amounts of U.S. government securities before the crash, pulling down the bond market and setting the stage for the collapse of equity prices.

Mr. Brady's comments are unlikely to be the last word on the subject since, for one thing, economists and stock market analysts are still trying to figure out the 1929 stock market crash. Obviously many people in the government and the private sector share responsibility for the latest disaster, but Mr. Brady's statement indicates the increased muscle of Japanese financial institutions.

The statement also underscores fears that Japanese investors may precipitously pull out of U.S. bond and equity markets, dragging them down and sending interest rates up and the dollar down. With their large financial holdings here, however, Japanese institutions have a stake in the stability of the dollar; the Japanese government has clearly been acting to protect that interest.

One indication comes from Japan's foreign currency reserves, now at a record high and the largest in the world, slightly ahead of Germany's. As the Table shows, growth has been accelerating in recent months; reserves reached a level of $84.9 billion at the end of March. Most of these reserves are in the form of short-term government securities, although a little over $1 billion is

in gold. The monthly increases in early 1988 are considerably smaller than those recorded in the corresponding months of last year, but the rate of increase is still large compared to most previous years.

Japan's Foreign Exchange Reserves

(in billions of dollars at end of each period)

	Level	Change From Previous Period
1982	$23,262	$-5,141
1983	24,496	1,234
1984	26,313	1,817
1985	26,510	197
1986	42,239	15,729
1987	81,479	39,240
1988		
January	83,407	1,928
February	83,821	414
March	84,857	1,036

Source: Ministry of Finance

Higher foreign exchange reserves have several implications. For one thing they suggest that the Japanese government is earning more than $2 billion a year in interest income on foreign securities, much of it in the United States. In 1986 and 1987, however, this was probably more than offset by a capital loss in yen terms on its dollar-denominated securities.

More importantly the higher reserve levels indicate activity in support of the dollar. One way to prop up the U.S. currency is for Japanese monetary authorities to buy dollars for yen, thereby adding to Japan's foreign currency reserves. As such, the figures represent past intervention. However, the Table does not give the complete picture since it includes only gold, cash and securities with a maturity of less than a year. Long-term assets are not included; in fact, they are not disclosed since the government does not want to tip its hand on the full extent of its intervention in the currency markets.

Outsiders can only hazard a guess as to the full extent of intervention. Pierre Languetin, the outgoing head of the Swiss National Bank, estimates that central bank intervention of all countries in 1987 totaled $140 billion, but Lloyds Bank PLC puts it at only $100 billion. With the dollar-yen exchange rate the focus of so much speculation last year, it is likely that Japan accounted for a fair chunk of the total.

Douglas Ostrom

Japan's Money Supply Still Surging

As a general proposition prices and the money supply are supposed to move together. Economists are quick to explain why the two may not be in

unusual step of asking the Ministry of International Trade and Industry to encourage some petrochemical producers to reopen shut-down plants, arguing that the increased production would reduce inflationary pressures. The bank's study also showed, as have previous studies, that increases in the money supply lead to price increases after a lag of several months. While few are expecting a return of the virulent inflation of the mid 1970s, Japan's years of remarkable price stability may be ending.

Douglas Ostrom

Research And Development Stunted In Japan?

Difficult economic conditions in fiscal 1986 (ending March 31, 1987) pared gains in research and development outlays by 15,500 Japanese organizations to just 3.4 percent in nominal terms, the smallest rise in at least 15 years. After adjusting for inflation, the figure improved to 4.1 percent, still the lowest since fiscal 1976's 3.5 percent increase. Although many analysts have argued that Japan does not cut research outlays during a downturn, adjusting to the stronger yen clearly blunted the growth of research spending.

According to a Management and Coordination Agency survey, total spending for research and development by 2,000 universities, 1,400 research organizations and 12,100 companies reached Y9,192.9 billion ($73.5 billion at Y125=$1.00) in fiscal 1986, a gain of Y302.6 billion ($2.4 billion). The rise was just one-quarter the previous year's 12.6 percent increase (see JEI Report No. 43A, November 13, 1987). In real terms the picture was only marginally brighter, with FY 1986's 4.1 percent showing still well below the 11 percent mark of the previous year. Because overall economic growth also lagged in fiscal 1986, R&D spending as a percentage of gross national product showed only a small decline from 2.77 percent to 2.75 percent. Compared to other countries, Japan is behind the United States, which spent $118.6 billion in fiscal 1986 or 2.82 percent of GNP, and West Germany, which devoted 2.83 percent of total output or DM52.2 billion ($31.4 billion at DM1.66=$1.00) in fiscal 1985 to research.

While private firms and research organizations retained their respective shares of total research outlays (see Table 1), the percent spent by universities continued to decline gradually. On the whole, the role of the government edged up a tiny 0.3 percentage point in FY 1986 to 21.3 percent of total outlays. In terms of growth, industry clearly pulled back in fiscal 1986 as the growth rate fell from 15.6 percent to just 3 percent.

The distribution among basic, applied and development research was almost unchanged from the previous year (see Table 2). Although industry has trumpeted a realignment of spending priorities to produce more basic research, company funds for this type of work rose only 0.2 percentage point to 6.1 percent. Similarly, despite a pledge to increase applied research by university laboratories, the distribution of funds was completely unchanged.

On closer examination it is clear that industry's response to hard economic times varied widely with respect to funding research (see Table 3). At one end of the spectrum, the pharmaceutical industry held growth to zero; at

Table 1: Japan's R&D Expenditures, FY 1981-FY 1986

(in billions of yen and percent)

Fiscal Year	Companies	Research Institutions	Universities	Total
1981	Y3,629.8	Y906.9	Y1,445.6	Y5,982.4
Change	15.5%	18.7%	7.9%	14.0%
Share	60.7%	15.2%	24.2%	100.0%
1982	4,039.0	949.3	1,540.4	6,528.7
Change	11.3%	4.7%	6.6%	9.1%
Share	61.7%	14.5%	23.6%	100.0%
1983	4,560.1	971.0	1,649.6	7,180.8
Change	12.9%	2.3%	7.1%	10.0%
Share	63.5%	13.5%	23.0%	100.0%
1984	5,136.6	1,033.1	1,724.2	7,893.9
Change	12.6%	6.4%	4.5%	9.9%
Share	65.1%	13.1%	21.8%	100.0%
1985	5,939.9	1,160.6	1,789.8	8,890.3
Change	15.6%	12.3%	3.8%	12.6%
Share	66.8%	13.1%	20.1%	100.0%
1986	6,120.2	1,240.2	1,832.6	9,192.9
Change	3.0%	6.9%	2.4%	3.4%
Share	66.6%	13.5%	19.9%	100.0%

Table 2: Japan's R&D Expenditures by Type of Research, FY 1985-FY 1986

(in billions of yen and percent)

Fiscal Year	Basic	Applied	Development
1985			
Companies	Y351.7	Y1,303.2	Y4,285.1
Share	5.9%	21.9%	72.1%
Research Organizations	131.5	320.4	616.1
Share	12.3%	30.0%	57.7%
Universities	547.4	378.2	84.7
Share	54.2%	37.4%	8.4%
1986			
Companies	371.3	1,321.8	4,427.1
Share	6.1%	21.6%	72.3%
Research Organizations	156.9	312.1	668.5
Share	13.8%	27.4%	58.8%
Universities	574.7	396.9	89.5
Share	54.2%	37.4%	8.4%

Table 3: Japan's R&D Expenditures by Industry, FY 1985-FY 1986

(in billions of yen and percentage change)

	FY 1985		FY 1986	
	Total	Change	Total	Change
Agriculture	Y4.5	-6.1%	Y4.3	-3.2%
Mining	21.7	15.8	21.7	-0.4
Construction	110.8	-4.6	121.1	9.3
Manufacturing	5,543.6	16.1	5,739.6	3.5
Food Products	133.5	7.9	147.2	10.3
Textiles	62.6	5.3	62.7	0.2
Pulp and Paper	32.4	11.2	33.9	4.7
Publishing and Printing	18.4	33.1	16.4	-10.9
Chemicals	936.4	9.8	983.6	5.0
Industrial Chemicals and Synthetic Fibers	377.8	9.1	709.0	8.3
Oils and Paints	89.2	5.9	97.9	9.7
Pharmaceuticals	341.9	15.8	342.0	0.0
Other	127.4	0.4	134.8	5.7
Petroleum and Coal Products	68.3	21.9	68.6	0.5
Plastic Products	65.6	2.4	70.0	6.7
Rubber Products	79.8	16.7	80.2	0.5
Nonmetallic Mineral Products	174.2	32.7	187.6	7.7
Steel	240.4	25.2	255.3	6.2
Nonferrous Metals	100.5	14.7	110.2	9.6
Fabricated Metal Products	102.7	23.0	94.7	-7.8
Nonelectric Machinery	382.7	13.4	379.1	-0.9
Electric Machinery	1,938.2	18.6	1,980.0	2.2
Communications and Electronics Equipment	1,322.0	20.6	1,360.4	2.9
Other	616.2	14.5	619.6	0.5
Transportation Equipment	935.7	15.8	989.8	5.8
Motor Vehicles	797.2	16.1	840.4	5.4
Other	138.5	13.9	149.4	7.9
Precision Machinery	201.7	20.5	199.2	-1.3
Other	70.6	5.4	81.2	14.9
Transportation, Communications and Utilities	259.3	17.6	233.5	-0.03
Total	5,939.9	15.6	6,120.2	3.0

Source for Tables 1-3: Management and Coordination Agency, Report on the Survey of Research and Development.

the other end, outlays by food product makers rose a healthy 10.3 percent. There appears to be no pattern. Export-oriented firms, which might have been expected to retrench, showed mixed results. Electronics and communications equipment manufacturers, for example, expanded outlays only 2.9 percent. Automotive makers, on the other hand, raised expenditures by nearly twice this amount. As for companies that focus on domestic demand, compare the strong growth of food product makers with the 10.9 percent cut in outlays by publishers and printers. Even levels of technological sophistication appear to have had little impact on spending changes. For example, solid growth in steel and nonferrous metals compared with weak growth by machine tool and electric machinery makers. It was clearly a chaotic year for budget planners.

Japan's technology trade also marked time. Total exports fell 4.3 percent in value terms and 7.1 percent in quantity, while imports shrank 11.1 percent and 2.4 percent, respectively. More significant was the reduction in the exchange of newly signed technology agreements, which had been moving generally upward. New exports dropped from 2,099 cases worth Y73.3 billion ($586.4 million) in fiscal 1985 to 1,730 cases valued at Y51.8 billion ($414.4 million) in the April 1986-March 1987 period, while new imports dropped to 1,141 cases from 1,245 cases, although their value rose slightly to Y33.6 billion ($268.8 million). Japan still showed a significant surplus in technology trade of Y18.2 billion ($145.6 million), but this was far less than FY 1985's Y40 billion ($320 million) level.

Despite all the Japanese rhetoric about being bullish on investing in future innovation, it is clear that economic difficulties restrain research budgets. Given industry's strong rebound from a difficult year, figures for fiscal 1987 should show a return to healthy growth.

Jon Choy

Trying To Find Middle Ground On Beef And Citrus

Japan has quietly done an about-face on trade in beef, oranges and orange juice. Elimination of the import quotas on these commodities -- dismissed up until a few weeks ago as impossible, at least in the medium term -- is now accepted as inevitable by 1993 at the latest, not only by senior members of Noboru Takeshita's government but by Liberal Democratic Party policymakers and farm group representatives as well. If matched by some flexibility in Washington's position, this little-publicized policy reversal opens the way for a cease-fire in the decade-long bilateral fight over access to Japan's beef and citrus markets.

Hints that Japan was prepared to go beyond its rejected March offer of continued annual increases in the quotas on beef, oranges and orange juice surfaced after talks April 13-14 in Washington between Deputy U.S. Trade Representative Michael Smith and Hidero Maki, vice minister of agriculture for international affairs. By the end of another round of Maki-Smith discussions in Tokyo April 19-22, it was clear that Japan had proposed a timetable for liberalization, although neither government directly acknowledged that the Takeshita administration had fulfilled the White House's precondition for negotiations on a replacement for the bilateral beef and citrus arrangement